



ARMENIA ENERGY TRAINING PROGRAM

Contract No. LAG-I-00-98-00011-00, Task Order Two

Technical Report

Course on Selling a Local Electric Company

May 7, 1999

Submitted to U.S. Agency for International Development

Submitted by the Academy for Educational Development
with Hagler Bailly Services

ARMENIA ENERGY SECTOR TRAINING PROGRAM
Technical Report
Course #4: Selling a Local Electric Company

USAID Strategic Objective 1.5	A more economically sustainable and environmentally sound energy sector
Intermediate Result 2	Increased economic efficiency in the energy sector
Participant profile	Armenia's energy companies, government ministries and regulatory entities with competence over the energy sector

A. Course Purpose

The objectives of the AED seminar were to identify major issues associated with the sale of government owned power sector enterprises, including preparation of preliminary financial and asset valuation of entities, as well as structuring a privatization process. The training stressed major issues for privatization of electric industry assets as Armenia begins aggressive implementation of asset privatization.

B. Dates/Trainers/Attendees

The course was conducted April 12-16, 1999. Russell Harding served as the primary instructor. Anahit Avetissyan of the Armenian Energy Regulatory Commission also taught a section of the course, and additional instructors included Dean White and MacNeill Watkins of Hagler Bailly.

Seven representatives of the Central Distribution Company were registered to go to the seminar, but were unable to attend: Samvel Gabrielyan, Rudolf Zohrabyan, Ashot Babayan, Korium Ghukasyan, Vardan Mesropyan, Grigor Khachoyan and Hoarout Avetikyan.

Table 1: List of Participants

#	Name	Employer	Apr 12	Apr 13	Apr 12	Apr 15	Apr 15
1	Areg Galstyan	Ministry of Energy					✓
2	Karen Sarkisyan	Ministry of Energy					
3	Marine Petrosyan	Ministry of Energy	✓	✓	✓	✓	✓
4	Rouben Margaryan	Ministry of Energy	✓	✓	✓		✓
5	Mels Petrosyan	Ministry of Energy					
6	Tigran Gnuni	Institute of Energy					
7	Svetlana Ganjumyan	Institute of Energy	✓	✓	✓	✓	✓
8	Shiraz Kirakosyan	Energy Regulatory Commission					
9	Yurik Budaghyan	Energy Regulatory Commission		✓	✓		✓
10	Vahagn Martirosyan	Energy Regulatory Commission			✓		
11	Anahit Avetissyan	Energy Regulatory Commission		✓	✓	✓	✓
12	Aram Karapetyan	Energy Regulatory Commission				✓	
13	Hrant Baghdasaryan	Yerevan Distribution Company	✓	✓	✓	✓	✓
14	Gayane Nacharyan	Yerevan Distribution Company	✓	✓	✓	✓	
15	Harutyun Mkhitarian	Northern Distribution Company	✓	✓	✓	✓	✓
16	Gagik Sahradyan	Ministry of Finance	✓	✓	✓	✓	✓
17	Vahe Babayan	Armenergo	✓	✓	✓	✓	✓
18	Vahan Mkrtchyan	Armenergo	✓	✓	✓	✓	✓
19	Arman Aharonyan	Strategic Institute	✓	✓	✓	✓	
20	Razmik Sardaryan	Central Distribution Company	✓	✓	✓	✓	✓
21	Meruzhan Hovsepyan	Central Distribution Company	✓	✓	✓	✓	✓
22	Gayane Sargsyan	Ministry of Privatization	✓	✓	✓	✓	✓
23	Oleg Markosian	Ministry of Privatization	✓	✓	✓	✓	✓
24	Vahandukht Minasyan	Ministry of Privatization	✓	✓	✓	✓	✓
25	Aleksan Antonyan	Northern Distribution Company	✓	✓			✓
26	Suren Babayan	Vorotan Cascade		✓	✓	✓	✓
27	Mickael Mickaelyan	Institute of Energy					✓
			16	19	19	17	19

C. Material Covered

The one week seminar identified major issues for privatization of electric industry assets as Armenia begins aggressive implementation of major asset privatization. The course reviewed experience from electric industry asset sales in the NIS (Georgia, Kazakhstan) and the US (using the SCE model) to educate Armenian decision-makers on the detailed steps/lessons learned from the privatization process. The course also identified the information necessary to prepare, market and conduct sales transactions to help improve the likelihood of successful privatization in Armenia and constructed a timeline and role/responsibility matrix for an asset sale in Armenia.

The first day and one half of the seminar dealt primarily with the question of how the energy sector of NIS countries can attract investment capital especially during a global recession, how energy systems are valued, market oriented regulatory reform as it relates to privatization, and how reform is progressing in CEE/NIS countries.

Two and one half days were spent reviewing the specific experience of Southern California Edison in the divestiture of their generation assets, the framework of the new energy trading markets in California, and specific discussion of due diligence information preparation, auction process preparation, technical and legal issues and timelines and role/responsibility matrix to provide a model for Armenian plans for privatization.

The last day was devoted to review of specific aspects of the privatization efforts in Georgia, and in particular, a discussion of the privatization of distribution to AES. This discussion included an overview of privatization efforts in Georgia, the actual process for privatization of distribution to AES and lessons learned and conclusions drawn from that experience. In addition, comparisons and contrasts were noted between efforts in Georgia and those being undertaken in Armenia. The course agenda is attached as Appendix A. Course materials presented are Attached as Appendix B.

D. Participant Evaluations

AED administered an exit questionnaire to assess participant satisfaction with the course immediately after its conclusion. The following key points emerged from the evaluation.

- Most of the participants believe that the course will be very useful for them, and that it was conducted at their level of expertise. Most of the participants (70.6%) consider the program to be directly relevant to their work, and anticipate they will be able to apply what they learned in their work
- Participants were satisfied with the quality of the interpretation as well as other logistics of the seminar. Satisfaction with interpretation and translation seems to be rising. (AED/HB recently have changed interpreters/translators in response to earlier feedback.)
- Most participants indicated that they have made arrangements to maintain contact with the instructors and/or each other through future conferences, telephone, etc.
- There was an even balance between participants who felt the seminar was long enough to meet their needs and those who would like to see a longer program.
- The participants requested a greater focus on Armenia as well as a greater use of case studies.

E. Anticipated Outcomes

Short-Term: The seminar participants gained sufficient knowledge of the conditions

necessary to attract private investment to the Armenia energy sector, and will be able to begin moving towards creating those conditions.

Long-Term: One theme that the participants appeared to understand was that the value of an asset is closely related to the market environment in which that asset is offered for sale. This is an important concept as Armenia heads into the privatization process, given that historically, there has been a focus on the asset itself and its value, rather than understanding that the privatization is focused on the business and not on the underlying assets, their historic or replacement costs, etc.

F. Recommended Follow-up

Feedback during the course indicated the audience's appreciation for practical information in addition to theory. In addition, actual experiences of transactions (including the contractual elements) were of great interest to the participants of the seminar. Next steps should consider providing additional detailed information of other recent transactions for privatization of electric sector assets, particularly those that have occurred in countries similar to the conditions that exist in Armenia. These detailed reviews should include a discussion of the political issues, legal issues, how the contracts were structured, how the economics of the transaction were relevant to both buyer and seller, and what lessons/conclusion could be drawn from them.

The AED team is in the process of revising the outline for the *Specification, Solicitation and Evaluation of International Invitations to Bid* course to provide additional case studies and detailed information along the lines recommended.

H. Conclusions

Overall, the workshop was positively received and was given high marks by the attendees. This seminar seems to have met its objectives and to have helped advance the reforms being undertaken under the Armenia Power Sector Reform project by increasing knowledge about privatization of electric utilities.

APPENDIX A

Seminar Outline Selling a Local Electric Company

Seminar Outline
Armenian Power Sector
Selling a Local Electric Company
Course Instructor: Russell Harding, Edison O&M

Day One:

10:00 AM Introductions

1. Course Objectives/Overview

10:45 AM Why Privatize?

1. International Trends
2. Objectives of the Privatization Process
3. Approaches towards Privatization

12:30 PM Lunch

1:30 PM Armenia: A Status Assessment

1. Review of Strategic Investor Privatization
2. Perceptions of Investors
3. Privatization Policy (Orders 551/555)
4. Lessons Learned from Privatization's in Armenia (including small hydro power)
5. Next Steps including Tendering for the Yerevan Distribution Company

4:00 PM Adjourn

Day Two:

10:00 AM Introduction to Restructuring in the U.S.

1. Separation of Generation, Transmission and Distribution
2. Electric System Reliability
3. Markets vs. Tariffs
4. Preparing Assets for Sale - Major Component Overview

12:30 PM Lunch

1:30 PM Major Components

1. Form of privatization
2. historical asset information
3. Diligence Information

4:00 PM Adjourn

Day Three:

10:00 AM Due Diligence (continued)

1. Engineering Assessments
2. Real Estate Issues
3. Sales contract components and development

1:00 PM Lunch

2:00 PM Marketing, sales brochure development, presentations and tours of assets

4:00 PM Adjourn

Day Four:

10:00 AM Conducting an Auction

1. Distribution of Materials
2. Conducting site visits
3. Q & A Process
4. Closing process

12:30 PM Lunch

1:30 PM Putting together a team

1. Next Steps
2. Time line and role/responsibility matrix

4:00 PM Adjourn

Day Five:

10:00 AM Telasi: Power Sector Privatization in Georgia

1. What Went Well and What Didn't?
2. Anticipated Next Steps in Georgia
3. Implications for Armenia
4. Develop time line and role/responsibility matrix for an asset sale

1:00 PM Lunch

2:00 PM Review and Discussion of Course Materials

1. Course Evaluation

4:00 PM Adjourn

APPENDIX B

Seminar Materials

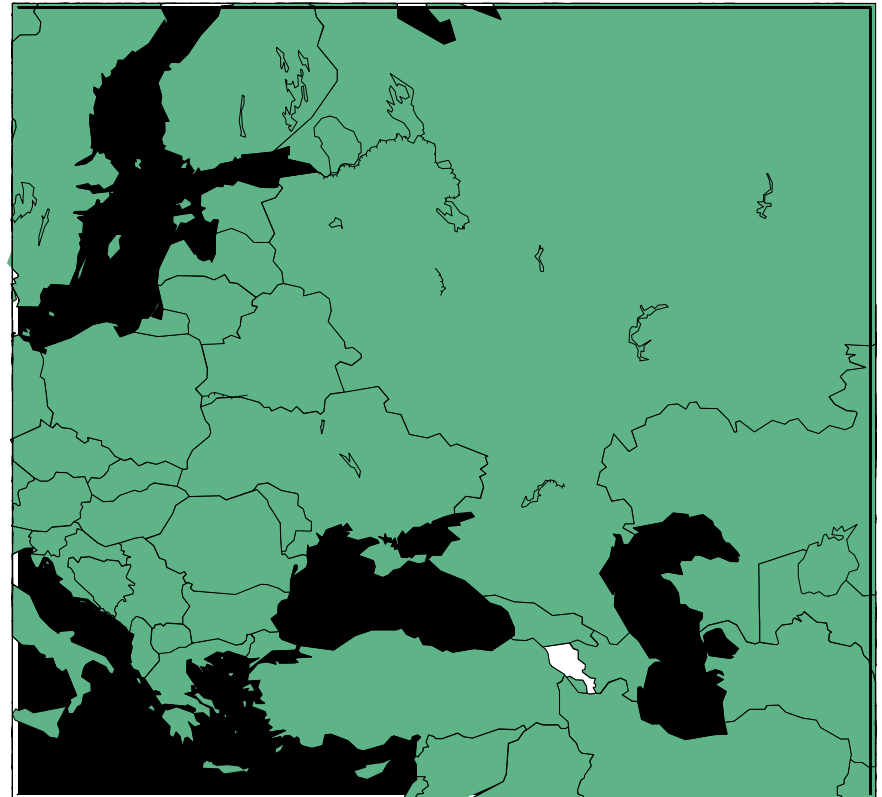
Selling a Local Electric Company



Hagler Bailly

Options for Power Sector Finance: The Role of Capital Markets, Development Banks, and Privatization

Presented by:
Dean White
Vice President
Hagler Bailly Services



Introduction

- ◆ The Ministry of Energy requested USAID technical assistance to examine **investment options** in the power sector and to develop an investment attraction strategy.
- ◆ Estimates place the power sector's investment needs at **\$1.7 billion** over the next ten years.
- ◆ The Government has planned to turn to the **private sector** for help with financing and managing power sector enterprises.
- ◆ Method of privatization is expected to involve **strategic investors**.
- ◆ An offering memorandum for a majority of Yerevan Distribution Company's shares is anticipated for mid-1999 and investment advisor retained.
- ◆ This analysis reviews the options available to Armenia and preliminary recommendations on a **strategy to attract capital** to the sector.

Objectives of Privatization

Some of the principal objectives of privatization include:

- ◆ **Raising capital** – The sale of shares enables the government to raise financing.
- ◆ **Efficiency gains** – The private sector drive to reduce costs and increase efficiency in order to maximize profits has resulted in dramatic gains in efficiency in a multitude of industries. But, tariffs must give the owners the proper signals.
- ◆ **Management improvements** – Private sector management can increase system reliability, improve billing and accounting, and remove politics from decision making.
- ◆ **Technology transfer** – Private owners will often refit facilities with technology upgrades in their effort to reduce costs and maximize profits. Again, closely tied to tariff.
- ◆ **Reducing the government's budgetary obligations** – Governments are increasingly relying on privatization to reduce the financial burden of energy investment.

Finance Principles

Without the ability to internally finance major capital undertakings, utilities frequently turn to the external capital markets.

- ♦ **Time value of money** - Inflation erodes the value of a future payment. To compensate lenders require a return (interest) on their investment.
- ♦ **Risk and Return** - The riskier the investment the higher the rate of return.
- ♦ **Power Project Risk** - Technical, commercial, regulatory and legal.
- ♦ **Political and Macroeconomic Risk** - Stability and cooperation of the government, currency risk, inflation rate, economic growth.
- ♦ **Debt/Equity Ratio** - High degree of leverage increases risk.
- ♦ **Financial Advisors** - Retaining a well respected investment bank/financial advisor is often the most important initial step in raising project capital.

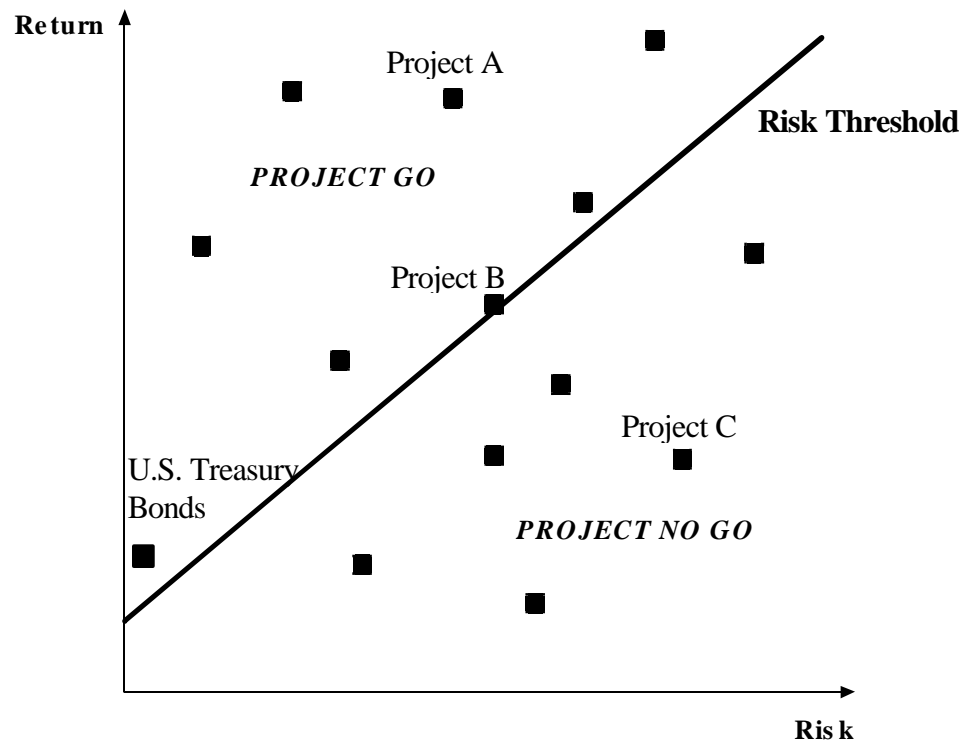
Background: Transmission Pricing

- ◆ Pricing **affects cash flow** - discounted cash flow basis for financing.
- ◆ Pricing is a complex exercise that has led to numerous pricing **methodologies**.
- ◆ Pricing should:
 - Promote the **efficient** day-to-day operation of the wholesale power market
 - Compensate the owners of existing assets for justified **fixed costs**
 - Signal the need for **investment** in the system
 - Signal **locational** advantages for investment in generation
 - Account for **losses**
 - Be simple and **transparent**
 - Be politically **implementable**
- ◆ The ability of the tariff to successfully address these pricing principles will greatly affect the company's **creditworthiness** and access to capital.

Infrastructure Finance

Risk and Return

Projects can be plotted according to their risk and return variables. The risk threshold of the investor or lender determines which projects are considered favorable for financing.



Debt Finance

Debt finance involves borrowing capital from an outside entity, this includes: Commercial Loans, Multilateral Development Bank Loans, and Bonds.

- ◆ The capital is essentially “**rented**” from the lender at a premium that reflects the actual amount borrowed (the principal), plus an interest payment.
- ◆ The interest rate is directly tied to the rate of inflation plus the aggregated risk associated with the project and the borrower (**risk premium**).
- ◆ The primary concern of the creditor is the potential of the borrower to **default**.
- ◆ Credit risk ratings for companies issued by international ratings agencies: Standard & Poors, Moody’s, Fitch IBCA, Duff & Phelps.

Debt Finance

Credit Ratings and Definitions:

Moody's	Standard & Poors'	Fitch IBCA	Duff & Phelps	Definitions
Aaa	AAA	AAA	AAA	Prime, maximum safety
Aa1	AA+	AA+	AA+	
Aa2	AA	AA	AA	High-grade, high quality
Aa3	AA-	AA-	AA-	
A1	A+	A+	A+	
A2	A	A	A	Upper-medium grade
A3	A-	A-	A-	
Baa1	BBB+	BBB+	BBB+	
Baa2	BBB	BBB	BBB	Lower-medium grade
Baa3	BBB-	BBB-	BBB-	
Ba1	BB+	BB+	BB+	Non-investment grade
Ba2	BB	BB	BB	Speculative
Ba3	BB-	BB-	BB-	
B1	B+	B+	B+	Highly speculative
B2	B	B	B	
B3	B-	B-	B-	
Caa	CCC+	CCC	CCC	Substantial risk
Ca	CCC	-	-	Extremely speculative
C	CCC-	-	-	May be in default
-	-	DDD	-	Default
-	-	DD	DD	
-	D	D	-	

Commercial Loans

Commercial Loans

- ◆ Lenders will **seldom finance 100%** of project costs, will require equity from borrower.
- ◆ The capitalization required for standard IPPs is typically **20-30%**.
- ◆ In a developing economy the capitalization rate required for project finance will be higher than in a developed country, **reflecting added risk**.
- ◆ Lenders assess the ability of the borrower to make the required **debt payments**.
- ◆ The lower the ability to cover the debt service (**DSCR**) the higher the risk.
- ◆ Bank loan will be based on the bank's **cost of capital plus the risk premium** of the project or borrower.
- ◆ Risk premium tied to the borrower's **credit rating**.

Types of Debt

Corporate Bonds

- ◆ Corporate bonds are **debt obligations** issued by companies to raise funds.
- ◆ Bondholders among the **first creditors to be repaid** in event of bankruptcy.
- ◆ **Credit rating and interest rate** will determine price of the bond.
- ◆ A borrower can issue its bonds in **local or foreign** capital markets.
- ◆ Bond issuance involves **underwriters** who sell the bond in the market.
- ◆ A **Eurobond** is a bond sold simultaneously in a number of foreign countries by an international syndicate of underwriters and is denominated in a major currency.

Equity Finance

- ◆ Equity capital can be generated internally or externally:
 - Internal equity (**balance sheet finance**) is accumulated through operations.
 - External equity is capital raised through the **sale of shares** in the company.
- ◆ For state-owned enterprises, external equity financing is equivalent to **privatization**.
 - The sale of stock in the company transfers ownership from **state to private** hands.
 - The degree to which the enterprise is privatized is largely determined by the **control** over the company management exercised by the private owners.
 - Companies not considered private until management control in private hands.
- ◆ The primary methods used to raise equity financing through the sale of shares include:
 - strategic investor
 - initial public offerings (IPOs)

Case Study: United States

Private Company Commercial Debt/Equity Finance

- ◆ American utilities rely primarily on the U.S. capital markets for financing.

USGen Revolving Bank Credit

Company: USGen (NYSE: PCG)
Loan amount: \$575 million
Interest rate: floating rate
DSCR: 5.16 x
Debt/Equity: 27%
Rating: BBB+ (Standard & Poor's)
Source: S&P Infrastructure Finance, December 1998.

CalEnergy Straight Bond

Company: CalEnergy (NYSE:CE)
Bond Principal: \$100 million
Maturity: 2008 (10 yrs.)
Coupon: 7.52%
Price: 102.24%
DSCR: 2.05 x
Debt/Equity: 78%
Rating: BB+ (Standard&Poor's)
Underwriter: CS First Boston
Source: CalEnergy press release 11/13/1998

CMS Stock Offer

Company: CMS (NYSE:CMS)
Shares: 4.5 million
Price: \$46.22/share
Gross: \$208 million
Shares Outstanding: 111.8 million
Net Earnings: \$293 million
Debt/Equity: 55.6%
Return on Equity: 14.8%
Underwriter: Salomon Smith Barney
Source: CMS press release, 11/10/1998

Strategic Investor

A strategic investor has the capital and operational expertise to rehabilitate, modernize, and improve the target company's operations and facilities.

- ◆ **Public Tender** - Qualified strategic investors submit bids according to predetermined rules and requirements set by the government.
 - A strategic investor will generally require **control** over the privatized company.
 - Bid prices are influenced by the discounted **cash flow** of the company.
 - Investment influenced by the **tariff rates** and methodology.
 - Rushing the tender process, selling only a minority share, providing incomplete financial data, and failing to reform tariffs will lead to low investor interest and, subsequently, low bid prices and investment commitments.

- ◆ **Bilateral Negotiations** - A direct sales agreement between a government entity and a strategic investor or group of investors.
 - Price of the equity stake determined through the **negotiation**.
 - Can be done **faster** than a public tender, but may result in **lower price**.

Case Study: Bolivia

Equity Finance: Strategic Investor

- ◆ In 1995, the Transmission de Electricidad (TDE) was carved out as a separate entity after the unbundling of the industry and was privatized through **public tender**.
 - TDE was awarded to a consortium made up of Union Fenosa, Banco Central Hispano, and the AIG-GE Capital Latin America Infrastructure Fund.
 - The Union Fenosa consortium was the **only bidder**, they paid \$40 million for 100% ownership of TDE and assumed to take on the company's \$70 million debt.
 - The bid just matched the **minimum price** set by the government. Low price reflects **indebtedness** of TDE and the **country risks**.

TDE Privatization

Company: Transmission de Electricidad (TDE)
Price: \$40 million + \$70 million debt
Initial ownership: 45% Union Fenosa, 45% AIG-GE Capital, 10% Banco Central Hispano.
Source: Union Fenosa, Press Release, 12/14/1998
Moody's, Press Release, 1/25/1999.

Case Study: Australia

Equity Finance: Strategic Investor

- ◆ **Victoria** the most progressive of the Australian states. Unbundled state utility into separate generation, transmission and distribution companies.
- ◆ Government offered **100% ownership** to strategic investors and attracted major U.S. utilities as well as National Power of the U.K.; investors paid a combine \$13.78 billion.
- ◆ PowerNet privatized through 1997 public tender won by GPU (**\$1.88 billion**).
- ◆ Financed through a \$1.4 billion **syndicated bank loan**, a \$450 non-recourse loan by Chase Manhattan Bank, and \$50 million in equity from GPU.

PowerNet Privatization

Company: PowerNet (Victoria)
Price: \$1.88 billion
Ownership: 100% GPU International
Debt/Equity: 74%
DSCR: 1.9 x
Credit Rating: A
Financial Advisor: J.P. Morgan
Underwriter: Chase Manhattan, Dresdner, and J.P. Morgan.
Source: GPU Press Release, 10/13/97; Duff & Phelps, Press Release, 5/29/ 98

Initial Public Offer (IPO)

An IPO refers to the initial sale of stock by a company to outside investors.

- ◆ Sale of shares to **general investment community**.
- ◆ Shares can be issued on **domestic or foreign** stock markets.
- ◆ Sale arranged through an **underwriter**, or syndicate of underwriters.
- ◆ Stocks must be registered with the proper stock market organizations.
- ◆ The maximum number of shares that can be issued is determined by the company's **authorized share capital** as specified in its articles of incorporation.
- ◆ The price investors are willing to pay for the shares is largely based on discounted **cash flow** analysis, growth expectations, and other value measurements used to determine the expected return on the investment.
- ◆ Greater **access to investors** can increase stock price, but may entail **high fees**.

Case Study: United Kingdom

Equity Finance: IPO

- ◆ England and Wales operate under **unified** transmission grid managed by a Transco.
- ◆ The National Grid Company (**National Grid**) was established in March 1990 as part of the privatization and restructuring program. REC/National Grid IPO raised **\$11.6 billion**
- ◆ National Grid Group Plc. was separated from the RECs in December 1995. The shares were not sold, but were instead distributed to the REC shareholders.

REC/National Grid IPO

Company: RECs (inc. National Grid)
IPO revenue: \$11.6 billion
Initial ownership: 55% individual investors, 30% institutional, 15% foreign (100% private).

Source: National Grid, Press Release, 12/14/1998
Moody's, Press Release, 1/25/1999.

National Grid Convertible Bond

Company: National Grid (Energis)
Bond Principal: \$400 million
Maturity: 2003 (5 years)
Coupon: 6%
Debt/Equity: 48%
Credit Rating: AA (credit watch: negative)
DSCR: 4.5 x
Underwriters: NM Rothschild & Sons and Dresdner Kleinwort Benson
Source: Moody's, Press Release, 1/22/99, Standard & Poor's, Press Release, 1/19/1999; National Grid, Press Release, 1/22/1999.

National Grid Share Offer

Company: National Grid (Energis)
Shares: 60 million
Share Price: \$26.40
Gross: \$1.58 billion
Outstanding Shares: 1.5 billion
Net Earnings: \$706 million
EPS: €31.68 (1998), €38.88 (1997)
Debt/Equity: 48%
Underwriter: Dresdner Kleinwort Benson and HSBC Securities
Source: Standard & Poor's, Press Release, 1/19/1999; National Grid, Press Release, 1/22/1999.

Concessions

Concession financing creates a contract with private developers to finance, build and operate utility assets, then turn the assets over to the government.

- ◆ A developer and state utility may agree to a predetermined tariff rate for an asset, based on the condition that the developer finance the construction of the asset.
- ◆ The developer is allowed to **operate** the asset for a specified period of time earning revenue based on the tariff rate.
- ◆ After the agreed upon time period ends the developer then **transfers** the asset back to the government.
- ◆ Many governments have reduced capital and operating costs of utility infrastructure projects and have **freed up their own capital** resources for other needs.
- ◆ **BOT** - Build-Operate-Transfer and variations (BOO, BOOT, MOO, etc.).

Case Study: Argentina

Equity Finance: Concession

- ◆ As part of the general restructuring of its electric power industry, Argentina privatized the transmission system in 1993 by offering **concessions** to private companies.
- ◆ The Ministry of Energy managed the two step concession tender:
 - 1) submission of **technical and financial** qualifications,
 - 2) submission of **financial** offer.
- ◆ Winning consortium led by National Grid and several Argentine and US companies.

Transener Concession

Company: Transener
Concession Term: 95 years (15 years O&M)
Concession Price: \$234 mm + \$70 mm debt
Ownership: 65% Citilec (National Grid - UK and Perez Companac - Arg., 35% government, 10% Transener employees
Debt/Equity: 18.8%
DSCR: 5.33 x
Credit Rating: BBB-
Source: Standard & Poor's *Infrastructure Finance*, March 1998.

Transba Concession

Company: Transba
Concession Term: 95 yrs. (15 years O&M)
Concession Price: \$220 mm + \$17 mm debt
Ownership: 90% Transener, 10% employees
Debt/Equity: 50%
DSCR: 2.5 x
Credit Rating: BB+
Fitch IBCA, Press Release, 12/29/1998, Duff and Phelps Credit Rating Co., Latin Power, October 1998



Multilateral Development Bank Loans

Development banks (World Bank, EBRD, ADB) use their creditworthiness to secure capital for developing countries at preferential rates.

- ◆ The World Bank has two principal lending programs for project finance:
 - International Development Association (**IDA**) - poorest countries
 - No interest payments, long-term, low administrative costs
 - Grace periods (up to 10 years)
 - \$6 billion per year.
 - International Bank for Reconstruction and Development (**IBRD**):
 - Long-term, low interest rates (fixed or float), several points above LIBOR
 - Grace Periods (often 3-5 years)
 - \$14 billion per year.
- ◆ The World Bank can also provide loan **guarantees** that may make certain commercial lending available.
- ◆ Loans typically contain macroeconomic **conditionalities**.

Case Study: Kazakhstan

Debt Finance: Multilateral Development Bank Loan

- ◆ In 1996, Kazakhstan's government issued a **decree** outlining the program for privatization and restructuring of the energy sector.
- ◆ In August 1996, the Kazakhstan Electric Grid Operating Company (**KEGOC**) established as part of the unbundling and privatization of the energy industry.
- ◆ In mid-1996, the Government issued a solicitation for a **25-year concession** to operate the national transmission grid. **Two bids** National Grid (U.K.) and ABB.
 - National Grid was awarded the contract but negotiations fell apart
 - In May 1997, the concession was given to the ABB consortium for \$20 million plus a commitment to invest \$1.4 billion over the length of the contract.
 - In June 1997 negotiations once again fell apart and the deal was **cancelled**.
- ◆ In late 1997 a new management team appointed to arrange investment capital.
 - Sought \$100 **Eurobond**
 - KEGOC's creditworthiness was rated **B-**
 - KEGOC bond would have to carry close to a **30%** interest rate.



Case Study: Kazakhstan

Debt Finance: Multilateral Development Bank Loan (cont'd)

- ◆ KEGOC abandoned its plans to issue the Eurobond and turned to the **World Bank** for assistance.
 - In late 1998 a World Bank team identified project needs of **\$266 million**.
 - The World Bank offered a low interest **loan** for \$100 million, plus credit **guarantees** for a \$100 sovereign bond to be issued by the government of Kazakhstan.
 - KEGOC to make an equity contribution of **25%** (\$66 million).
 - The World Bank loan is currently under development.

KEGOC World Bank Loan

Company: KEGOC (Kazakhstan)
Bank Loan: \$100 million plus \$100 in guarantees for a sovereign bond.
KEGOC Equity: 25%
Interest Rate: 6.30% (LIBOR-based)
Repayment terms: 20 years (5 year grace period)
Conditionalities: complete unbundling of the transmission company, establish separate wholesale market and ISO, reform transmission tariff.



Recommendations

- ◆ There is little to no project finance available from domestic sources in Armenia. The Armenian power sector must look for **international sources** of capital. Kazakhstan can be used as a benchmark.
- ◆ Kazakhstan's creditworthiness rated **B+** by several international credit ratings agencies.
- ◆ Kazakhstan has:
 - Considerable positive economic potential resulting from its **mineral wealth**.
 - Significant **political and macroeconomic risk**.
 - Government bonds carry coupon set at US Treasury Bond +15% (**21%** total).
- ◆ **Additional risks** in Armenia include:
 - Continuing military **hostilities** with neighboring Azerbaijan.
 - Economic **embargo** by both Azerbaijan and Turkey.
 - **Lack of experience** in international financial markets (unknown to most investors).
- ◆ It is likely that sovereign bonds issued by the Armenian Government would be rated lower than Kazakhstan's B+ rating and would have to carry a coupon in the range of 21-30%. KEGOC rated B- with 30% coupon required on their Eurobond.

Recommendations for Distribution

- ◆ The government of Armenia has committed to privatization of the distribution sector in 1999, using a strategic investor approach. This is a positive step that should help to:
 - attract investment into distribution sector.
 - improve efficiency in operations.
 - improve management talent.
 - Address the collection problem.
 - Leverage additional investment into the power sector.

- ◆ In the meantime, asset value can be enhanced by:
 - further strengthening of the regulatory framework
 - implementation of license fees
 - follow through with successful licensing
 - refining various amendments to the Energy Law
 - removal of quotas
 - implementation of additional market reform recommendations
 - establishment of a funds administrator outside of Armenergo
 - pushing forward with commercialization of other sectors
 - water is particularly problematic.

Recommendations for Transmission

- ◆ A preliminary strategy for attracting investment capital to the transmission sector of Armenia can be identified based on the following factors:
 - significant investment requirements (\$300 million over 10 years).
 - need to establish independence of the transmission company.
 - need to introduce improved management and system control practices.
 - potential political resistance to sale of transmission monopoly.
- ◆ Hagler Bailly recommends a *concession agreement* to convey the rights to own, operate, and maintain the transmission system to a strategic investor for *no less than 20 years*.
- ◆ The concession should be issued through a *public tender*.
- ◆ The structure of the concession agreement needs to focus on *future investment* and must be supported by an appropriate tariff methodology.
- ◆ A two step tender process will allow the government to first *select qualified bidders* and then choose the best financial proposal from this group.
- ◆ Government of Armenia should review the terms and conditions in the bid documents prepared by other countries which held concession tenders for their transmission utilities.

Recommendations for Generation

- ◆ Need to attract investment in new thermal capacity and rehabilitation of hydropower cascade. Some limited new hydropower capacity is possible.
- ◆ Need to begin now as Government commitment to shut down ANPP at the end of 2004 requires sufficient replacement capacity be in place.
- ◆ Focus should be on capacity and energy needs, not on unit-specific approaches.
- ◆ Creativity of the private sector should be solicited, especially for difficult problems such as Hrazdan 5.
- ◆ Each type of resource (e.g. thermal, hydro) will require its own unique approach.
- ◆ Investment attraction will be helpful through implementation of the reform recommendations just noted. Sequencing distribution privatization to occur prior to generation privatization provides a way to enhance generation asset value.

Selling a Local Electric Company

Russ Harding

Southern California Edison

Intro to Restructuring in the U.S.

- The majority of the electric industry in the U.S. is privately owned by Investor Owned Utilities (IOUs)
- Until recently, these were fully integrated companies which owned generation, transmission and distribution facilities with a virtual monopoly over their service territories.

Intro to Restructuring in the U.S.

- The IOUs are heavily regulated by:
 - individual states who set their rate structures
 - and
 - federal government which regulates the transmission of high voltage electricity

Return on Capital + O&M costs =
Allowable rate of Return

Intro to Restructuring in the U.S.

- Recent legislation at both state and federal level has encouraged a “re-structuring” of the industry
- Many states have given electric utility customers choice as to their electric service providers

Intro to Restructuring in the U.S.

- Many IOUs have been encouraged to sell-off generation to third parties
- The IOUs are incentivized by the promise of recovery of “stranded costs”
 - return on and of capital is recovered over a short period of time, usually at a lower rate of return

Intro to Restructuring in the U.S.

- New markets have been created to allow for the trading of energy between parties, much like a commodities market
- Reliability issues have resulted in new entities being created solely to ensure that energy is available to market participants

Intro to Restructuring in the U.S.

- Transmission and distribution O&M costs and return on capital continue to be regulated
- Generation O&M costs and return on capital must be captured through the market

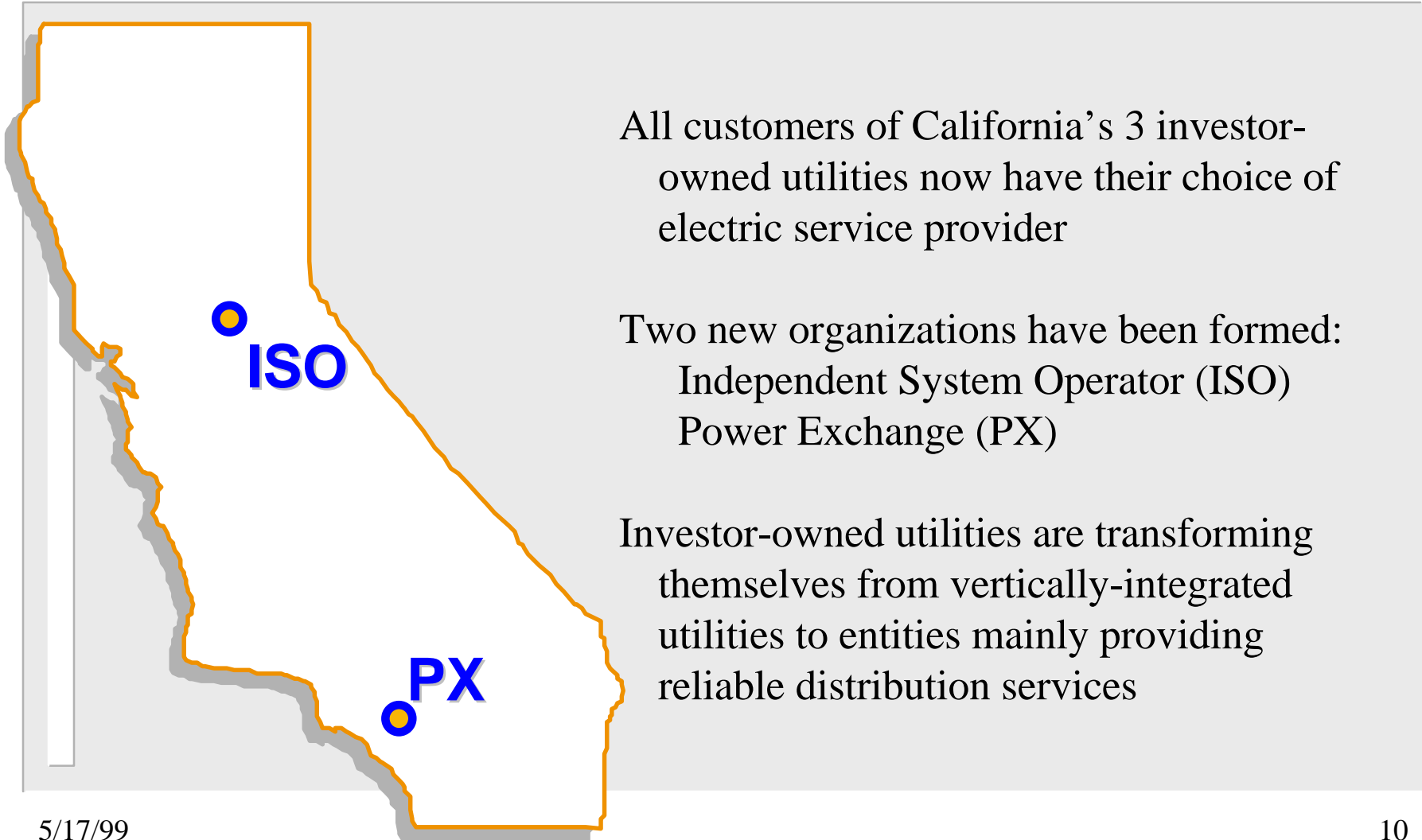
Intro to Restructuring in the U.S.

- Generation, transmission and distribution
 - generation is owned by many entities and available over a wider geographic region
 - transmission, though owned by the IOUs, is managed by separate entities (like the ISO)
 - distribution is still owned and maintained by the IOUs

California's New Electricity Market

- AB1890 passed - September 1996
- Trust formed - Early 1997
- First management hired - July 1997
- Tariff, Protocols, Sec 35 filed mid to late 1997
- Defining “Operational Readiness” - Fall 1997
- Delaying the market opening - December 1997
- Day-ahead market opened - March 31, 1998

California's Deregulated Electricity Market Is Off To A Successful Start



California's New Market Entities

Independent System Operator (ISO)

- **Manages grid reliability**
- **Provides non-discriminatory open transmission access**
- **Controls generation and transmission dispatch**
- **Coordinates power scheduling**

Power Exchange (PX)

- **Operates an open, efficient electricity commodity market**
- **Runs market auctions daily**
- **Establishes market clearing price for each hour**

Running the PX Auction:

Bidding and Scheduling

■ Day Ahead Market

1830 (2 days ahead) ISO estimates reliability must-run, overgen, other

0700 Participants submit initial bids

0930 Participants submit ancillary services and resource schedules

1000 PX submits initial preferred schedule to ISO

1100 ISO accepts initial preferred schedules or submits suggested adjusted schedules (reflecting congestion)

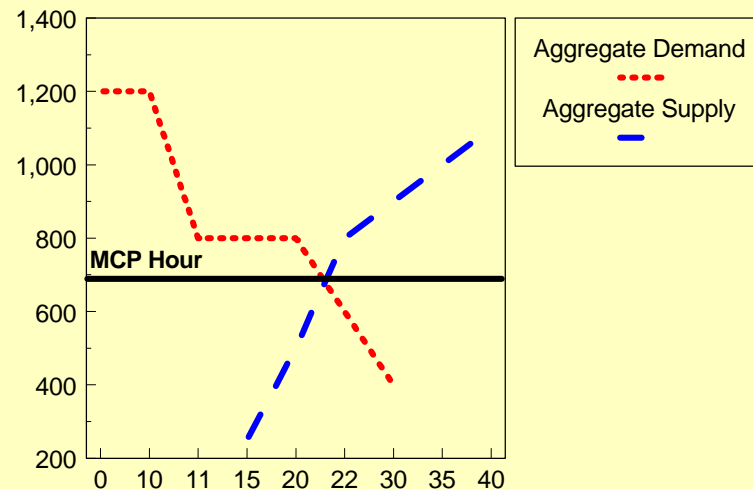
1200 PX resubmits initial preferred schedule

1300 ISO submits finals schedules; PX communicates to participants

How the Market Clearing-Price is Determined

- Demand and supply bids accepted - 24 settlement periods
- Bids aggregated to form demand and supply curves
- MCP is intersection of supply and demand bids
- May be adjusted for congestion

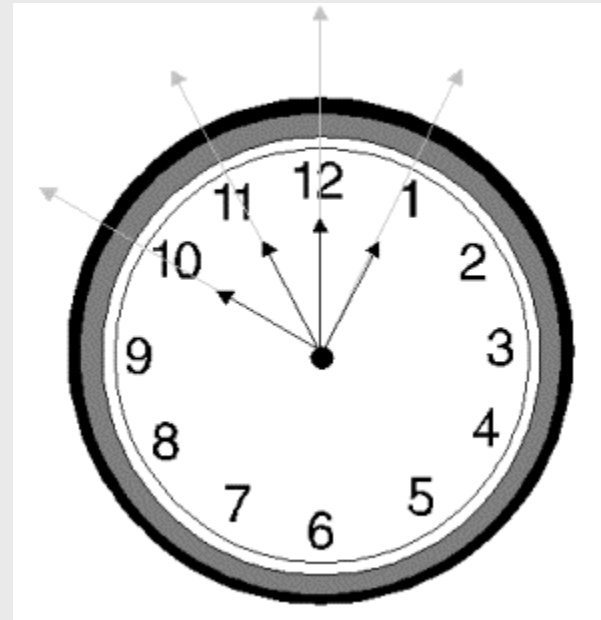
Determining the Market-Clearing Price



The Scheduling of Power

ISO Scheduling Coordinator Day Ahead Market

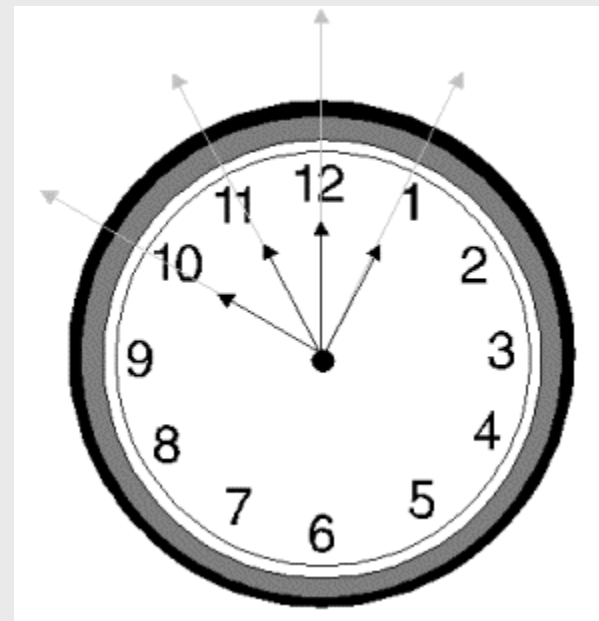
10:00 a.m. Scheduling
Coordinators submit to the Cal-ISO how much power they think their customers will need for the next day and what power plants will produce that energy.



The Scheduling of Power

ISO Scheduling Coordinator Day Ahead Market

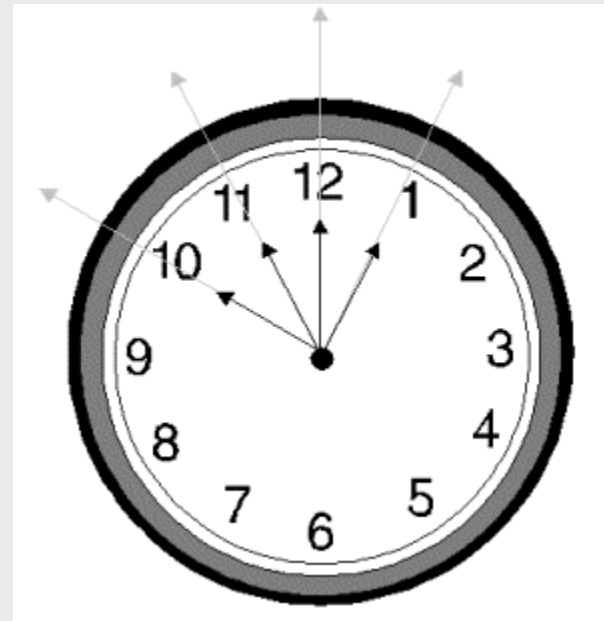
11:00 a.m. Cal-ISO is ready to give Scheduling Coordinators the signal to either proceed with their schedules or modify them-giving them suggestions on how to do so.



The Scheduling of Power

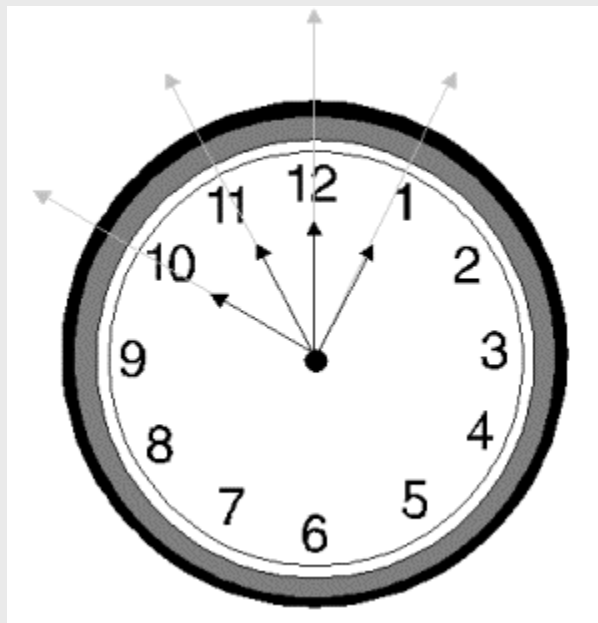
ISO Scheduling Coordinator Day Ahead Market

12:00 noon Scheduling
Coordinators submit revised
schedules. This time if the
schedules conflict, Cal-ISO
automatically modifies them
to flow with the other
schedules.



The Scheduling of Power

ISO Scheduling Coordinator Day Ahead Market



13:00 Cal-ISO closes the Day-Ahead market and the charge for use of congested lines is calculated.

Running the PX Auction:

Bidding and Scheduling

- PX day of Market
Started January 17, 1999

TIMELINE

Auction Close Time	Bidding Hours
6:00 AM	HE 11-16
12:00 PM	HE 17-24
4:00 PM	HE 01-10

ISO Markets

- Real-Time Imbalance Market
(Spot Market)

The highest volume of Cal-ISO energy trading is through the Real-Time Imbalance Market

ISO Markets

Ancillary Services Market

- Regulation (AGC)
- Spinning Reserve
- Non-Spinning Reserves (Capacity Available in Ten Minutes)
- Replacement Reserves (Capacity Available in 60 Minutes)

ISO Markets

Congestion Management Market

- Adjustment bids
(Hour ahead and Day Ahead Markets)
- Used to manage Over-scheduled transmission paths
- Used to manage Overloaded transmission paths in real-time market

Overview - Southern California Edison

- Southern California Edison (SCE) is a fully integrated electric utility
- Owns generation, transmission and distribution as an integrated system
- Restructuring resulted in the sale of all 12 of its fossil generating stations (9,560 MWs)

Overview - Southern California Edison

- 12 separate fossil (gas/oil)generating plants sold through auction
- Transmission facilities and associated land (switchyards) retained by SCE
- Fuel oil facilities and associated land retained by SCE
- Certain telecommunications equipment retained by SCE
- Vacant land retained by SCE

Overview - Southern California Edison

- Separation of transmission facilities (switchyards), fuel oil facilities, and telecommunications equipment from generating facilities created the need to establish the provision of services between the new owners of the generating plants and SCE

Overview - Southern California Edison

- Retention of property associated with transmission, fuel oil and vacant land necessitated:
 - legal adjustments to existing real estate lots and
 - creation of associated agreements for access

Overview - Southern California Edison

- SCE continued operation and maintenance of sold assets for 2 years as a condition of sale
 - included labor, procurement of materials and supplies, telecommunications
 - did not include fuel purchase, bidding of power into the market, procurement of permits

Major components of an Asset Sale

- Form of Privatization
- Historical Asset Information
- Marketing Efforts
- Sales Contract Structure
- Auction Process
- Closing Process

Major components - Form of Privatization

■ Definition of assets

- Generation vs. Transmission vs. Distribution

■ Definition of markets

- Who will be selling to whom

- Includes both energy and ancillary services

Privatization- Definition of assets

■ Physical boundaries of equipment

- presents a logical separation
- identifies equipment to be retained and/or sold to another buyer

■ Real estate boundaries

- Methodology for asset sale
- Retained real estate
- Drawings and maps

Privatization- Definition of markets

■ Division of Markets

- California ISO/PX relationships
- Metering (where, who owns it, maintenance, responsibility)
- Ancillary Services
 - regulation (frequency control)
 - spinning reserves
 - non-spinning reserves (10 minutes)
 - replacement reserves

Major components - Asset Information (historical)

- Financial
- Technical
- Legal
- Environmental

Asset Information - Financial

- Due Diligence Financial Information
 - At least 5 years of O&M cost data
 - At least 5 years of Capital cost data
- Provides bidders with historical profile of costs
- Allows bidders to estimate future “going forward” costs

Note: any future “must take” costs should be identified

Asset Information - Financial

Historic Annual Data

(Dollars in Thousands)

<u>Station Costs</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>
Operation Expense	\$4,458.6	\$4,851.7	\$4,955.0	\$4,984.9	\$4,612.7
Maintenance Expense	13,657.7	9,980.1	5,704.2	7,425.2	5,753.5
Supply/Tool Expense	579.7	321.2	345.9	273.7	173.7
Overhead Expense	<u>2,766.9</u>	<u>3,196.8</u>	<u>2,620.6</u>	<u>1,457.8</u>	<u>1,405.4</u>
Total Non-Fuel Direct Station Costs	<u>21,462.9</u>	<u>18,349.8</u>	<u>13,625.7</u>	<u>14,141.6</u>	<u>11,945.3</u>
Allocated Overhead and Common	<u>15,639.9</u>	<u>6,269.5</u>	<u>3,846.8</u>	<u>4,287.1</u>	<u>5,597.3</u>
Total Non-Fuel O&M Costs	37,102.8	24,619.3	17,472.5	18,428.7	17,542.6
Fuel Expense	<u>119,924.3</u>	<u>136,677.6</u>	<u>146,785.0</u>	<u>117,302.8</u>	<u>101,356.7</u>
Total Costs	<u>\$157,027.1</u>	<u>\$161,296.9</u>	<u>\$164,257.5</u>	<u>\$135,731.5</u>	<u>\$118,899.3</u>
<u>Capital Spending</u>	<u>\$25,801.8</u>	<u>\$23,370.3</u>	<u>\$20,263.6</u>	<u>\$9,918.3</u>	<u>\$486.8</u>
<u>Labor Costs</u>	<u>\$15,801.3</u>	<u>\$17,760.5</u>	<u>\$17,399.7</u>	<u>\$16,285.3</u>	<u>\$14,740.1</u>

Asset Information - Technical

- Provides engineering, operations, maintenance, technical and performance information about asset
- Looks at equipment, modes and efficiency of operation, historical maintenance work and practices
- Can be done either internally or externally

Asset Information - Technical

- A technical review typically contains:
 - Executive Summary
 - Site description and characteristics
 - Process and equipment descriptions
 - Performance data
 - Operational characteristics and maintenance practices
 - Decommissioning studies (if any)
 - Appendices with references, staffing, outage plans, etc.

Technical Review

■ Executive Summary

- Purpose
- Assumptions and scope
- Station Description
- Conclusions

Technical Review

■ Site Description and Characteristics

- Site Location and Description
- Transmission Interface
- Community
- Site map
- Infrastructure (access & utilities)
- Geological and Natural Hazards
- Fire Hazards and Protection
- Security
- Support Structures and Facilities

Technical Review

■ Process and Equipment Description

- Components of major Systems
- Fuel supplies and Systems
- Water supplies and Systems
- Electrical Systems
- Air Systems
- Balance of Plant Systems
- Transmission Systems

Technical Review

■ Station Performance

- Heat Rate
- Operating Limitations
- Minimum Loads and Ramp Rates
- Operating Statistics

Technical Review

- Operations and Maintenance
 - Operational Characteristics
 - Maintenance Practices
- Decommissioning Studies
 - Any existing studies

Overview of Historical Asset Information

■ Due Diligence Legal Information

- Guaranties
- Liabilities
- Government consents
- Compliance with laws
- Litigation (outstanding claims)
- Contracts (transferability and consent)
- Software
- Patents
- Licenses

Due Diligence - Legal

■ Guaranties

Identifies any obligations seller is bound to pay or perform following the close of the sale

Due Diligence - Legal

■ Liabilities

assumed liabilities: those liabilities to be assumed by the buyer

excluded liabilities: those liabilities to be retained by the seller

Due Diligence - Legal

- Government Consents (both buyer and seller)

Identifies all government consents necessary from courts or government parties/agencies associated with a sale and which would have a material impact on the assets or operation of the assets

Due Diligence - Legal

■ Compliance with Laws

Describes any issues where the asset being sold is not in compliance with current laws

Only applicable where non-compliance is material to operation of the asset

Due Diligence - Legal

■ Litigation

Any actions, suits, claims or proceedings which would affect the assets or which relate to the assets

Due Diligence - Legal

■ Contracts

- Assumes all contracts are in full force
- Seller has not granted power of attorney
- No first rights of refusal
- Describes any where there is material breach or notice to terminate or cancel

Due Diligence - Legal

■ Software

Identifies consents for all software to be transferred

- Process Control

- Shrink wrap

- Home grown

Due Diligence - Legal

■ Patents

Identifies any patents to be transferred

Due Diligence - Legal

■ Licenses

Lists all of the proper documents issued by government agencies necessary for a buyer to operate on their first day of ownership and/or they are aware of what licenses, permits, plans and authorizations they need to obtain

Asset Information - Environmental

- Bidders want to know about the historical environmental conditions at the site
 - Establishes a baseline for existing contamination
 - Identifies which parties will be responsible for past contamination

Asset Information - Environmental

- Environmental Assessments
 - usually conducted by an independent contractor
- Phase I and II site assessments
- Proponents Environmental Assessment (PEA)

Asset Information - Environmental

■ Phase I Site Assessment

- Identifies known areas of contamination and identifies possible “hot spots”
- Consists of the following:
 - research and review of documents provided by the seller
 - research and review of regulatory agency reports
 - site visits and interviews of site personnel

Asset Information - Environmental

■ Phase II Site Assessment

- Follows up on results of the Phase I Assessment
- Includes sampling of the site to verify existing contamination and identify previously unknown contamination

Asset Information - Environmental

- Proponents Environmental Assessment (PEA)
 - required by regulatory agency
 - identifies impacts to the environment due to a change in ownership of the site for:
 - Aesthetics
 - Agricultural Resources
 - Air Quality
 - Biological Resources
 - Cultural Resources
 - Geology
 - Hazardous Materials
 - Land Use and Planning

Asset Information - Environmental

continued

■ Proponents Environmental Assessment (PEA)

- required by regulatory agency
- identifies impacts to the environment due to a change in ownership of the site for:

- | | |
|-------------------------|-----------------------|
| -Aesthetics | -Mineral Resources |
| -Agricultural Resources | -Noise |
| -Air Quality | -Population & Housing |
| -Biological Resources | -Public Services |
| -Cultural Resources | -Recreation |
| -Geology | -Traffic |
| -Hazardous Materials | -Utilities |
| -Land Use and Planning | -Water Quality |

Asset Information - Environmental

■ Proponents Environmental Assessment(PEA)

Identifies whether changes in ownership for each area will result in:

- Potentially significant impacts
- Less than significant with mitigation
- Less than significant
- No impact

Real Estate

- Surveys
- Land Title
 - encumbrances
 - leases
 - licenses
 - rights of way
 - easements
 - taxes

Real Estate

- Limitations on use
- Grant limitations
- Water Rights
- Transfer of Interest provisions
- Rights of First Refusal
- Assignment limitations
- Ongoing liabilities

Major components - Sale Contract

- Confidentiality and Auction Protocols
- Asset Sales Agreement
- Regulatory Agreements for selling power

Sale Contract - Confidentiality and Auction Protocols

- Establishes the rules for conducting an auction
- Timeline and requirements of Bidders
- Confidentiality of information provided to bidders
- Short list vs. all interested parties

Sale Contract - Asset Sales Agreement

- Legal document that sets the terms and conditions of the asset sale
- Includes references to other agreements that must be signed
 - Easement and Covenant agreement
 - Facilities Services Agreement

Sales Contract Components

- Basic Transactions
- Representations and Warranties
- Covenants of each Party
- Conditions to Closing
- Closing
- Termination
- Indemnification
- General Provisions

Sales Contract - Basic Transactions

- Purchased and Excluded Assets
- Assumed and Excluded Liabilities
- Any Related Agreements
- Purchase Price and Adjustments

Sales Contract - Basic Transactions

■ Related Agreements - Facilities Services Agreement

- provides for services to retained land and facilities historically provided by the sold asset and not economical to separate

- for items such as compressed air, water, fire protection, roadways, parking, electrical energy, heat energy

Sales Contract - Basic Transactions

■ Facilities Services Agreement

- sets terms and conditions by which these services will be provided, which party pays, and under what conditions and terms payment is made
- establishes responsibility for maintenance and investment in equipment which provides those services
- establishes procedures for either party should they elect to remove or discontinue the provision of these services
- establishes communication processes between the parties where provision of these services will be impacted

Sales Contract - Basic Transactions

■ Related Agreements - Easement and Covenant Agreement

-describes rights of both parties to property for operation and maintenance of equipment owned by one party but located on the property of the other party

Sales Contract - Basic Transactions

■ Easement and Covenant Agreement

- Allows for encroachments
- Improvements
- Restrictions
- Alterations to equipment
- Liability Insurance
- Indemnification
- Remedy process for Defaults

Sales Contract - Basic Transactions

■ Easement and Covenant Agreement

- Vehicle access
- Pedestrian Access
- Fire Protection Systems
- Service Water Systems
- Fuel Systems
- Waste Water Discharge Systems
- Electric Services
- Telecommunications

Sales Contract - Representations and Warranties

- Organization, Authority and Enforceability
- Approvals
- Permits, Contracts, Litigation
- Compliance with Laws
- Brokers
- Plant Data
- Exculpation

Sales Contract - Covenants of each Party

- Reasonable Commercial Efforts to Close
- Control and Cooperation
- Expenses
- Access
- Conduct Pending Closing
- Casualty or Condemnation

Sales Contract - Closing

- Date, Time and Place
- Deliveries by Buyer
- Deliveries by Seller
- Method for delivery of Purchase Price amount

Sales Contract - Termination

- Sets terms and conditions by which transaction may be terminated
- Mutual Consent
- Effect of termination
- Modification of Terms

Major components - Marketing

- Investment banker
- Brochure
- Symposiums
- Advertising

Marketing - Investment Banker

- Experienced in the market of electric asset sales
- Resource for contacting possible interested parties
- Screens for serious players
- Knows the type of information serious players are interested in
- Adds legitimacy to an auction process

Marketing - Brochure

- Development of a Sales Brochure
- Should include:
 - Introduction of the process
 - Overview of the Markets
 - The Auction Process and schedule
 - Description of the Assets for sale
 - Summaries of the Transaction Agreements
 - Requests for Additional Information

Marketing - Symposiums

- Series of meetings describing the transactions, process and assets to be sold to all interested parties
- Can be done in country, regionally or internationally
- Sales Brochures are typically distributed

Marketing - Advertising

- International Business publications
- Symposiums
- Contacts through government and private individuals
- Contacts through investment community
 - banks
 - Investment Banker

Major components - Auction Process

- Overview
- Distribution of due diligence materials
- Site visits
- Q&A process
- Contracts signed
- Closing

Auction Process-Overview

- The Auction process must be perceived as fair and impartial
- Every interested party must receive the same information regarding the assets up for auction
- Confidentiality of the process by both buyer and seller important

Auction Process-Overview

■ Steps:

- Sales Brochure and Advertising
- Offering Memorandum
- Initial non-binding indications of interest
- Short list due diligence
- Final Bids
- Award and signing of documents
- Closing

Auction Process - Distribution of Due Diligence Materials

- Offering Memorandum
- Regulatory Filings
- Technical Review
- Asset Sales and Related Agreements

Offering memorandum

- Supplied to serious bidders
- Provides more detailed information about sale process and the assets to be sold
- Includes discussion of the market

Offering memorandum

■ Executive Summary

- Overview
- Plant Auction Process
- Transaction Agreements
- Auction Timetable and Protocols
- Bidding Restrictions and Common Assumptions
- Regulatory Approval Process

Offering memorandum

■ Investment Considerations

- Competitive Market
- Strategic Location
- Repower Opportunities
- Maintenance and Condition of the Assets
- Fuel Supplies
- Environmental Risks
- Regulatory Approvals

Offering memorandum

- Markets and Restructuring
 - Overview
 - Market Structure
 - Electric Rates
 - Electric System Reliability
 - The Power Market

Offering memorandum

■ Asset Sale Overview

- Assets being sold and retained

- Facility Description

 - type of units, dependable loads, operating dates

 - major components

 - fuel supplies

 - facilities

 - historical operating data

 - historical financial data

 - historical performance data

Offering memorandum

■ Environmental Considerations

- Introduction
- Air Quality and Emissions limits
- Waste Water Considerations
- Hazardous Materials and Hazardous Wastes
- Permits
- Real Estate

Offering memorandum

■ Transaction Agreements

- Introduction
- Asset Sales Agreement
- Assumed and Excluded Liabilities
- Purchase Price and Adjustments
- Conditions to Closing

Regulatory Filings

- Filings seeking permission to sell utility property (State)
- Filings seeking permission to turn over operational responsibility to Independent System Operator (Federal)
- Filings of Environmental Impacts

Technical Review

- Provided to short list of bidders

- provides the major portion of technical data about the assets for use by the bidders in determining the asset statistics and condition

Asset Sales and Related Agreements

- Provided to short listed bidders

- establishes terms and conditions of the asset sale including obligations of both buyer and seller

Auction Process - Site visits

- Bidders will want to tour the assets being sold
- Format
- Rules
- Logistics

Site visits - Format

- Opening presentation which provides:
 - Recent operating data
 - Recent maintenance activity
 - Major overhaul history
 - Personnel
- Tour of the facility (guided)

Site visits - Rules

- Number of personnel per tour
- Tour guides
- Questions asked
- Tour route
- Access to site personnel
- Recording devices
- Disclaimers

Site visits - Logistics

- Transportation
- Lodging
- Food
- Number of days for each tour

Auction Process - Q&A process

- Many questions will be asked during the auction process (legal, regulatory, technical)
- All questions should be recorded or submitted in writing
- All answers should be given to all bidders
- Q&A sessions should be scheduled separately from tours

Contracts Signed

- Final bids are submitted by interested short listed bidders
 - many come with conditions which require negotiation
 - provides and opportunity to evaluate the various bids for alignment with objectives
 - asset sale and related agreements are signed

Major components - Closing

- Necessary permits and authorizations must be transferred to allow buyer to operate upon closing of sale
- Arrangements for transfer of purchase price
- Finalize any negotiations that occurred during bidding
- Final signing of documents

Major components - Putting together the Team

- Project Management
- Knowledge of the assets (technical)
- Legal (contracts) knowledge
- Regulatory
- Marketing

Major components - Putting together the Team

■ Project Management

- a consultant functioned as project manager for overall preparation, and auction of the 12 fossil generating plants

- a key ingredient was the high level of support given to project manager (who reported directly to company President)

Major components - Putting together the Team

■ Knowledge of the assets (technical)

- team consisted of individuals knowledgeable of the assets (operations, maintenance & engineering backgrounds)

- a site person was selected as a point of contact and coordinator of efforts required of site personnel

Major components - Putting together the Team

■ Legal (contracts) knowledge

- knowledge and experience in the development of sales contracts played an important part in the process

- an outside law firm knowledgeable in asset transactions was hired to assist

Major components - Putting together the Team

■ Regulatory

- experts in regulatory requirements and environmental law were important to the effort
- both internal and external legal counsel were utilized

Major components - Putting together the Team

■ Marketing

An Investment Banking Firm was hired to:

- market the assets
- assist in the development of materials for sales brochures and the Offering Memorandum
- help coordinate the site tours
- assist in the Q&A process

Major components - Putting together the Team

■ Lessons

- Ensure support from the highest levels possible (to remove barriers to cooperation)
- Identify clearly defined areas of responsibility to avoid duplicating work
- Have the team in close contact to speed cooperation

Project Timeline

- Due Diligence Information: 4-5 months
- Real Estate Issues: 5-6 months
- Preparation of Asset Sales Agreement: 2 months
- Preparation of Auction Materials: 2 months
- Conducting the Auction: 3-4 months
- Closing: 1-3 months

Auction Timeline

Auction Transaction	201d	5/17/99	2/21/00
Distribute Protocol and CA	1d	5/17/99	5/17/99
Distribute Initial Bid Package	1d	6/1/99	6/1/99
Initial Indications of Interest	1d	8/2/99	8/2/99
Selection of Short List	5d	8/2/99	8/6/99
Due Diligence, Plant Tours, etc.	44d	8/6/99	10/6/99
Final Bids	1d	10/6/99	10/6/99
Selection of Winner	7d	10/6/99	10/14/99
Regulatory Approvals	47d	10/14/99	12/17/99
Permit Transfers	35d	11/1/99	12/17/99
Sale Close	1d	12/20/99	12/20/99
Final Price Adjustment	1d	2/21/00	2/21/00

Roles/Responsibilities

Asset Definition

Real Estate

Equipment

Miscellaneous Assets

Consents

Plant Condition

Historic Financial Data

Compliance

Liabilities

Staff

Proj Manager

Duration/Timing

Roles/Responsibilities

Proj Manager Duration/Timing

Regulatory/Compliance Activities

Filings
Studies

Pre Auction Activities

Initial Bid Package (Offering memorandum)
Sales Brochure
Asset Sales (and other) Agreements

Roles/Responsibilities

	Proj Manager	Duration/Timing
Auction Activities		
Solicitation of interested parties		
Distribution of due diligence materials		
Distribution of auction protocols		
Site Tours		
Q&A		
Negotiations with final bidders		
Closing Project Manager		
Corporate and/or Government Approvals		



Next Steps